



INTERNAL RECONSTRUCTION

STUDENT NOTES

Meaning :- It is process to reorganise the affairs of Company. It is done by :-

1. Revaluation of Assets.
2. Reassessment of Liabilities.
3. Reducing the Paid-Up Value of Shares.
4. Varying the rights of shareholders

All of this is done to write off the losses already suffered by the company.

Methods of Internal Reconstruction

1. Alteration of Share Capital

Sub-division of Share

S.L. →
$$\begin{aligned} \text{FV: } 100 \times 5000 &= 500,000 \\ \text{FV: } 10 \times 50,000 &= 500,000 \end{aligned}$$

Share capital of the company is sub-divided to Shares of Small denomination.

Consolidation of Share

$$\begin{aligned} \text{FV: } 10 \times 50,000 &= 500,000 \\ \text{FV: } 100 \times 5,000 &= 500,000 \end{aligned}$$

Share capital of the company is consolidated to Shares of higher denomination.

Conversion of Shares into stock & vice versa

$25\%, 33\%, 36\% \rightarrow 1 \text{ stock} \rightarrow 7.5\%$
 50000

A company can convert its fully paid up share into **Stock*** & vice versa.

Eq. Sh. Cap. A/c Rs.100 Dr. $500,000$
 To Eq. Sh. Cap. (Rs. 10) A/c $500,000$

Eq. Sh. Cap. A/c (Rs. 10) Dr. $500,000$
 To Eq Sh. Cap. (Rs. 100) A/c $500,000$

Eq. Sh. Cap A/c (400*10) Dr. 4,000
 To, Eq. Stock A/c 4,000

Under both the scenarios amount of Share Capital remains the Same.

Stock :- A Stock is a bundle of fully paid Shares, that are consolidated for convenience, so that it may be divided into any amount and transferred into any fractions without regard to the original face value of shares.

2. Variation of Shareholders' Rights.

Where a company has two different classes of Shares, the company can vary the Rights of any Class of Share.

Example:- (i) Rate of dividend may be changed.

(ii) Voting Rights may be changed.

(iii) Cumulative Shares may be converted into non-cumulative share



Internal Reconstruction :- company → loss making

↓
Books of Accounts → Balance Sheet

↓
Restructure → present paap → khatam

In this chapter, we are going to learn how to restructure/reconstruct the balance sheet.

B/S

S-L. 2cr. - 0.5 = 1.5cr.
R.S. → (8cr.)
+ 7.5
(0.5)

Bank loan Reduce by 1cr. SDL

Trade payables Reduce by 1cr. SDL

Assets : Land
Building

Goodwill

BV = 10cr. → 0

Reduce by 10cr. ✓

Increase by 18cr. ✓

2cr. → Sale Value = 20cr.

5cr. → Sale Value = 3cr.

Reduce by 2cr. ✓

+ 18cr.

- 2cr.

- 10cr.

+ 5DL

+ 1cr.

7.5 crore → faeda → paap mita salata hai

+ 0.5

8.0 crore

Internal Reconstruction

↓

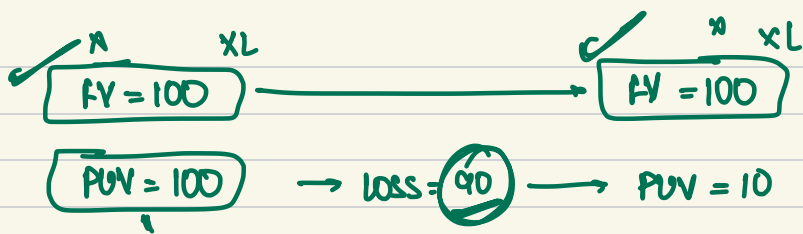
first approval of all concerned parties.

↓

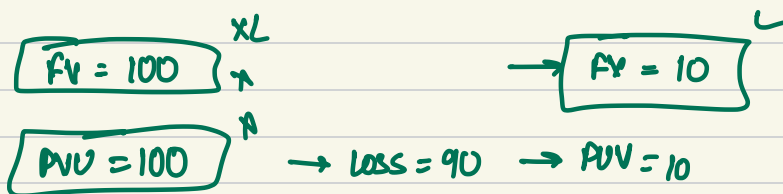
Court → approval

↓

Scheme of Internal Reconst. can be implemented.



Share Capital	Dr	90
To, Profit		90



Share Capital (100)	Dr.	100
To, Share Capital (10)		10
To, Profit		90

METHODS OF INTERNAL RECONSTRUCTION

1. Alteration of Share Capital

Sub Division of Shares

O	N
FV = 100	FV = 10
No = 10000	No = 100000
SC = 1000000	SC = 1000000

Equity Share Capital (FV=100) Dr. 1000000
To, Equity Share Capital (FV=10) 1000000

Consolidation of Share

O	N
FV = 10	FV = 100
No = 100000	No = 10000
SC = 1000000	SC = 1000000

Equity Share Capital (FV=10) Dr. 1000000
To, Equity Share Capital (FV=100) 1000000

Conversion of Shares in Stock & Vice-versa

Equity Share Capital Dr. 1000000
To, Equity Stock 1000000

4. Compromise / Arrangements

with creditors, bank loan, debentures etc.

Eg:- Debentures = 500,000
 250,000 given up (assumed)
 250,000 Equity Shares

5. Surrender of Shares

a.	O	N
Alteration :-	FV = 100	FV = 10
	No = 10000	No = 100000
	SC = 1000000	SC = 1000000

Shareholders will surrender their 40/50/60% shares towards the company.

Company will use these shares to pay off their liabilities. Any excess shares left with the company will be finally cancelled.

2. Variation in Shareholder Rights

- Dividend Rights changed.
 - Rate of Dividend
 - Cumulative → non-cumulative
- Voting Rights.

3. Reduction in Share Capital

Cancelling the right for uncalled capital.

FV = 10 ^{XL}	FV = 8 ^L
PV = 8	PV = 8

Right to call 22 → given up.

Equity Share Capital (FV=10) Dr. 8
To, Equity Share Capital (FV=8) 8

Repay the excess capital called

FV = 10 ^{XL}	FV = 8 ^L
PV = 10	PV = 8
	Repay = 2

Equity Share Capital (FV=10) Dr. 10
To, Equity Share Capital (FV=8) 8
To, Shareholders / Bank 2

Reducing the paidup capital i.e. lost/unrepresented

Only paidup value is reduced

FV = 10 ^{XL}	FV = 10 ^{XL}
PV = 10 → L=9	PV = 1

FV continues to be 10
Equity Share Capital Dr. 9
To, Capital Reduction (Profit) 9

Both facevalue and paidup value are reduced.

FV = 10 ^{XL}	FV = 1 ^L
PV = 10 → L=9	PV = 1

FV changes from 10 to 1
Equity Share Capital (FV=10) Dr. 10
To, Equity Share Capital (FV=1) 1
To, Capital Reduction (Profit) 9



**STUDENT
NOTES**

Share Capital A/c (old rights) A/c Dr.
To Share Capital A/c (new rights) A/c

3. Reduction of Share Capital.

1. **Extinguishing /Reducing Liability for unpaid amount.**

E.g. Partly Paid-up Shares Rs 7.5 each converted into fully paid-Up Share Rs 7.5/-

Share Capital (Rs.10) (partly Paid-Up) Dr. 7.5
To Share Capital (Rs 7.5) (Fully Paid up) 7.5

2. **Paying off any excess Capital.**

E.g. Fully Paid-up Shares Rs.10 each, Rs.2/Share paid off to make fully paid up Share Rs.8 each

Share Capital (Rs.10)	Dr.	10
To, Share Capital (Rs.8)	A/c	8
To, Shareholders A/c		2

Shareholders	2
To Paula	2

3. Cancelling the Paid-up capital that is lost or not represented.

Only Paid-Up Value is Reduced.

Example:- Nominal value = Rs.100/share.

Paid-up Value Reduced by Rs.90/share.

Share Capital A/c Dr. 90
To Capital Reduction A/c 90

- **Only Paid-up Value is reduced.**
- **Nominal value /share continues to be the same.**

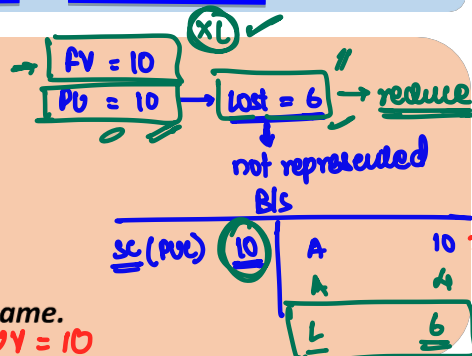
$S.C \rightarrow FV = 100 \quad PVY = 10$

Both Nominal and Paid-Up is reduced.

Example:- Nominal value and Paid-up Value both Reduced by Rs.90/Share.

✓ Share Capital A/c (Rs.100) Dr. 100
 ✓ To Share Capital A/c (Rs.10)
 ✓ To Capital Reduction A/c

- **Paid-up Value & Nominal value /share gets reduced.**



A

XL

FV = 100

FV = 100 - 90

✓ = 10

Handwritten notes on a board:

- $xy = 10$
- $puv = 10$





INTERNAL RECONSTRUCTION

Creditors

Bank loan

4. Compromise/Arrangements.

500,000

STUDENT NOTES

ESC

Agreements between company and its Shareholders or Outside liabilities

Shareholders give up claim to reserves or accumulated profits.

Reserves /profits A/c Dr.

To, Capital Reduction a/c

Settlement with Liability for lesser amount.

Outside Liabilities A/c Dr.

To, Capital Reduction a/c

5. Surrender of Shares.

In this method ,Share are first divided into shares of smaller denominations and Shareholders are then made to surrender their shares to the company.

These Shares are then issued to outside liabilities to reduce their claim.

The unutilized surrendered Shares are cancelled by transferring to Capital reduction A/c.

Special Points:-

Shares Surrender

① FY = 100 Number = 100,000

FY = 10 Number = 10,00,000

Alteration

50% shares surrender → give up.

500,000 sh.

Trade payables

1,00,000 sh.

Bank loan

1,50,000

Debtors

200,000

50,000

Shares cancel.

CA Tejas Suchak

In the books of Heale Ltd.

<u>1.</u>	Equity share capital (£100) Dr.	100,00,000	
	To Equity share capital (£40)		40,00,000
	To Capital Reduction a/c (Profit)		60,00,000
	↓		
	Capital Reconstruction a/c		
<u>2.</u>	12% Preference share capital (£100) Dr.	50,00,000	
	To 12% Preference share capital (£60)		30,00,000
	To Capital Reduction (Profit)		20,00,000
<u>3. a.</u>	10% Debentures (100) Dr.	40,00,000	
	To 12% Debentures (100)		40,00,000
	b. 12% Debentures (100) Dr.	40,00,000	
	To 12% Debentures (70)		28,00,000
	To Capital Reduction (Profit)		12,00,000
<u>4. a.</u>	Creditors Dr.	80,00,000	
	To Capital Reduction (Profit)		80,00,000
	b. Creditors Dr.	12,00,000	
	To Equity share capital (FY=40)		12,00,000
<u>5.</u>	Capital Reduction Dr.	37,50,000	
	To Fixed Assets		37,50,000
<u>6.</u>	Capital Reduction (Loss) Dr.	55,00,000	
	To Current Assets		55,00,000
<u>7.</u>	Provision for taxation Dr.	10,00,000	
	Capital Reduction (Loss)	50,00,000	
	To Bank		1,50,00,000
<u>8.</u>	Capital Reduction Dr.	50,00,000	
	To Investments		50,00,000
 Capital Reduction bal = 65,00,000			
<u>9.</u>	Capital Reduction Dr.	65,00,000	
	To P&L		60,00,000
	To Capital Reserve (bal.)		50,00,000

The balance of Capital Reduction will be used to w/off the accumulated losses (i.e. Dr. balance of P&L) even if it is not mentioned in the question. It is compulsory to pass the above effect.

After writing off the Dr. bal of P&L if there is any balance in Capital Reduction, the same will be transferred to **Capital Reserve a/c**.



INTERNAL RECONSTRUCTION

STUDENT NOTES

The following scheme of reorganization is sanctioned:

- (i) All the existing equity shares are reduced to ₹ 40 each.
- (ii) All preference shares are reduced to ₹ 60 each.
- (iii) The rate of interest on debentures is increased to 12%. The debenture holders surrender their existing debentures of ₹ 100 each and exchange the same for fresh debentures of ₹ 70 each for every debenture held by them.
- (iv) One of the creditors of the company to whom the company owes ₹ 20,00,000 decides to forgo 40% of his claim. He is allotted 30,000 equity shares of ₹ 40 each in full satisfaction of his claim.
- (v) Fixed assets are to be written down by 30%.
- (vi) Current assets are to be revalued at ₹ 45,00,000.
- (vii) The taxation liability of the company is settled at ₹ 1,50,000.
- (viii) Investments to be brought to their market value.
- (ix) It is decided to write off the debit balance of Profit and Loss account.

$$20L - 40\% = 12,00,000$$

$$Bal = 12,00,000$$

$$30000 \times 40 = 12,00,000 \text{ (₹-s)}$$

Pass Journal entries and show the Balance sheet of the company after giving effect to the above.

(notebook page no.)

Question 6

Category:-

The summarized Balance Sheet of M/s. Ice Ltd. as on 31-03-2015 is given below

Liabilities	₹	Assets	₹
1,00,000 Equity shares of ₹ 10 each fully paid up	10,00,000	Freehold property	5,50,000
4,00,000 8% Preference shares of ₹ 100 each fully paid	4,00,000	Plant and machinery	2,00,000
6% Debentures 4,00,000 (secured by freehold property)		Trade investment (at cost)	2,00,000
Arrear interest 24,000	4,24,000	Trade receivables	4,50,000
Trade payables	1,01,000	Inventories-in trade	3,00,000
Director's loan	3,00,000	Profit and loss account	5,25,000
	22,25,000		22,25,000

The Board of Directors of the company decided upon the following scheme of reconstruction with the consent of respective stakeholders:



CA Tejas Suchak